

Summary of Recommendations

TAX RECOMMENDATIONS

- **1 – Governments** at the local, state, and national levels – when considering the application of existing and proposed tax laws to electronic commerce – should abide by basic tax principles: Neutrality, the lowest rates on the broadest base, transparency, and ease of implementation for taxpayers.
- **2 – State and national governments** should rationalize and harmonize rules for income, property, and consumption taxes to reduce (i) government and private sector compliance costs, and (ii) the likelihood that economic activities will be taxed more than once. A coordinated effort will help produce clarity, certainty, and neutrality and can reduce overlapping taxes and conflicting requirements, which in turn will promote the expansion of e-commerce. For example, if an agreement can be reached among the states that sales tax jurisdiction will not be asserted merely on the basis of where a server is located – the position taken by the California Board of Equalization – then there will be one less basis on which two states might try to tax one transaction twice.
- **3 – A streamlined tax system** should be devised for mail order, telemarketing, television home shopping, and e-commerce retail sales of goods. The system would allow the states into which physical goods are shipped to require the seller to collect and remit sales and use taxes. This will require federal legislation, preferably based on a plan devised by state and local governments working with the Advisory Commission on Electronic Commerce that has been created by the Internet Tax Freedom Act. The new system should include, among other elements, the following –
 - A low-cost system for implementation – such as a unified set of definitions for determining which goods are taxable, and a single point of tax reporting and remittance in each state for retailers.
 - A low-cost system for compliance – such as requiring that any audit that is performed be done at the state level (that is, explicitly not at the county or tax district level), accommodating the possibility of consolidated multi-state tax audits, and providing a safe-harbor rule for good faith compliance in the collection of sales taxes that only permits prospective remedies that carry no penalties.
 - An agreement that authoritatively establishes that sales taxes will be collected by the merchant on behalf of the "destination" state to which the goods are shipped.
 - A comprehensive approach that applies to all interstate sales and shipments of tangible goods – including mail order sales, telephone sales, and cable TV "home shopping" sales, as well as Internet e-commerce. Unless all forms of interstate sales of tangibles are covered, the principle of tax neutrality will not be served for tangibles.
- **4 – The *status quo*** should be maintained for taxing the interstate sale of intangibles and provision of services. In other words, the proposed federal legislation that would authorize states to require sales tax collections by out-of-state sellers would apply *only* to the sale of tangible products. This approach recognizes that effectively collecting taxes on intangibles and services would be inherently difficult because even the most conscientious merchant will not know for certain where his or her "goods" are being electronically "shipped". After all, to paraphrase a famous Internet aphorism: On the Internet, no one knows you're a German Shepherd, a Chinese Shar-pei, or the mutt next-door.

- **5 –** The California Board of Equalization, which administers the sales tax laws, should periodically consider whether sales and electronic delivery of software, music, books, magazines, and other such goods (which are non-taxable under current law) have become so significant that sales of such products in tangible form should also be made nontaxable. For example, if software delivered electronically captures more than 35 percent of the market, the principle of tax neutrality – as well as equity for consumers and among sellers – would support elimination of sales taxes on so-called "shrink wrapped" software that is delivered in a physical medium, such as a CD-ROM. The Board should report to the Governor and the Legislature its findings about the on-line distribution channel as it develops, recommending tax reductions as appropriate to achieve comparable tax treatment between the digital and physical markets.

- **6 –** Once a new system for taxation of interstate sales is in place, California and each other state that levies a sales tax should review the tax-base-broadening revenue impact of the new system and consider reducing its sales tax rate. For example, states could lower the rate such that there is no net increase in aggregate sales tax revenues. While the Council is not recommending that a state adopt any particular rate, we do draw attention to the tax principles at issue, specifically that the best tax policy embodies a broad base and low rates. Since a law allowing a state to collect sales taxes on interstate sales helps that state meet the base-broadening goal, the state should also strive for the second goal – lower rates.

PRIVACY RECOMMENDATIONS

- **1 –** Companies engaged in e-commerce – sellers, advertisers, portals, Internet service providers, software companies, and others – should continue promoting broad industry implementation of good privacy practices, as well as educating consumers about steps they can take to achieve their desired level of on-line privacy.

- **2 –** Government should work with industry to promote an annual "National Internet Privacy Day" to help consumers achieve the level of privacy they want for themselves and their families as they use the Internet to communicate, learn, and shop. The first year's event will be held in early 1999. Members of the Council who operate Internet portal sites, along with other portal site operators, Internet service providers (ISPs), and other companies offering e-mail services will be asked to send an e-mail to each customer (but not those who have asked to be left alone) outlining ways in which they can protect their on-line privacy. Links will be provided to websites where consumers can find out additional information about privacy policies, as well as tips on privacy protection. Consumers will be provided information about ways to customize the software they use to read e-mail in order to filter out unsolicited commercial e-mail, or "spam", how to find free and commercial software products to control personal information accessible to websites they visit, and how to protect the privacy of children who send and receive information over the Internet. Government at all levels can participate by posting links on their web pages to these information sites.

- **3 –** All on-line businesses should disclose (a) what information its website collects about those who visit, (b) how that information is used by the website operator, (c) whether it is made available to other affiliated or non-affiliated companies and under what conditions restricting use and further dissemination, and (d) what general steps are taken to protect the information from unauthorized access (i.e., hacking). As more and more businesses post informative privacy notices, a consumer will be able to choose whether to patronize a website with a posted privacy policy that meets his needs *versus* a site with a less-restrictive policy or none at all. The Federal Trade Commission should continue to work with companies, industry associations, and consumer groups to promote good privacy practices and disclosure to consumers – as well as developing model terms from which website operators could choose and upon which they could build their privacy policies. Model terms would help ensure that consumers clearly understand a website's privacy policies. Additionally, since the FTC has made clear that it will move against websites that do not meet the terms of whatever privacy notice is posted, model terms would help website operators avoid inadvertent conflicts between their posted policies and their actual data practices.

- **4 –** Following California's lead in passing Internet anti-junk-mail legislation¹, Congress should pass a bill that requires unsolicited commercial e-mail ("spam") to be labeled as an advertisement, to include information that accurately indicates the sender's return e-mail address, and to provide an e-mail address for sending a request to be removed from the mailing list used to send the e-mail. Additionally, Congress should pass legislation that requires anyone sending unsolicited commercial e-mail to accurately indicate the e-mail's origin and that prohibits someone from making use of a mail server unless authorized to do so. For example, one of the new California laws requires senders of *unsolicited* commercial e-mail to place "ADV:" at the start of the subject line, while the subject line of any commercial e-mail intended for adults must start with "ADV:ADLT".
- **5 –** Congress and appropriate federal agencies, working with consumer groups and interested industries, should consider how Internet-focused privacy initiatives – those already taken, being contemplated, and being recommended by this Council – might be applied to channels of commerce in the off-line world. Whether businesses are collecting data on-line or off-line (for example, product warranty cards, sweepstakes forms, and buyers clubs), or are marketing on-line or off-line (that is, telemarketing and direct mail), comparable standards could eliminate concerns about discrimination between industries – that is. dealing with "privacy", not simply "Internet privacy." Regardless of any action government might take, we urge the off-line industries to review the data practices we are recommending and consider implementing them by their own initiative.
- **6 –** The federal government should overhaul its current restrictions on the export of encryption technology, taking fully into account actual foreign availability of comparable technologies. For example, Netscape's Internet browser and e-mail application – "Communicator"TM – that incorporates 128-bit encryption technology may not be exported from the US to foreign consumers. Yet, using any of the popular Internet search engines, it takes only a few minutes to find foreign-based websites from which one can obtain free add-on software – independently developed by foreign software developers – that will augment CommunicatorTM so that it will have 128-bit encryption capabilities. This fact *should* justify eliminating the current ban on exporting the 128-bit version of CommunicatorTM, and a truly rigorous foreign availability review of encryption technology would support substantially broader deregulation.

CONSUMER PROTECTION RECOMMENDATIONS

The "self-regulatory" model that is being discussed as an adjunct or alternative to government regulation generally describes businesses acting responsibly and industry associations providing "quality labels" and, if needed, private enforcement. However, "self-regulation" can also describe the approach that consumers should take – that is, consumers "self-regulating" by learning about a seller before deciding to buy. This has been happening.

Additionally, the Council has been pleased to see that state consumer protection agencies, working with the Federal Trade Commission and other federal law enforcement agencies, have deployed resources to fight Internet fraud. This is not to say that the challenges of operating in the digital world will be easily met. Undoubtedly, adjustments in operating methods will be necessary. And, when buyers and sellers may be separated by thousands of miles and even international borders, some problems will require international agreements, while others may be intractable. Additional resources may be justified to fund enforcement efforts. However, all indications to date suggest that state and federal enforcement agencies are determined to respond to consumers' needs. Therefore, we have no specific recommendations to make in this area.

CALIFORNIA RECOMMENDATIONS

- **1 –** California should continue its realistic approach to Internet regulation – building on its record of moving quickly and responsibly to help e-commerce businesses and consumers in the Internet world. Already, California has enacted laws establishing open-technology guidelines for digital signatures², blocking discriminatory Internet taxes³, outlawing Internet junk-mail (so-called "spam")⁴, requiring state websites to post privacy notices⁵, and extending the protections of general mail-order consumer rules to Internet sales⁶. An example of California's realistic approach is its recognition that some state legislative initiatives deal with Internet matters that ultimately can best be handled at the federal level; for example,

recent state anti-spam legislation contains an explicit self-destruct provision triggered by enactment of comparable federal legislation. Normally, a state law only becomes inoperative if it is struck down by a court or is repealed.

- **2 – California** should commence an industry-specific and agency-specific review of existing regulations to ensure that they do not discriminate against Internet-based businesses. This review should be carried out through a dialogue between the regulators and the regulated – with full access and opportunities for input provided to interested consumers – and its purpose should be to determine which regulations, or which parts of certain regulations, are no longer meaningful when applied to the online conduct of the business affected. Based on anecdotal evidence, it seems unlikely that a review of existing laws and regulations will require extensive resources, because it appears that relatively few existing state laws specifically impinge on e-commerce beyond the State's regulation of professionals. Therefore, reviews can generally be based on requests. Nevertheless, agencies should make it clear to the business community and the general public that they are open to input and will respond quickly.
- **3 – Government agencies in California** should expand their use of the Internet to provide information to the public, and they should devise and deploy applications that allow individuals and businesses to submit documents and receive responses via the Internet – with appropriate attention to privacy and security concerns. It should be emphasized that government's deployment of transaction-capable e-commerce offers particularly great promise to small businesses, for whom the proverbial "government red tape" is more than an annoyance – it is very costly.
- **4 – California** should continue to fund programs aggressively that expand the integrated use of, and access to, information technology throughout California's education system. As made clear by numerous expert study commissions, education is a building block of a sound economy, and this is especially true for high-tech businesses.
- **5 – California** government websites should be rated for content, and carry appropriate electronic markings, under existing and developing content rating systems. Otherwise, children whose websurfing is being protected by filtering software may be blocked from accessing appropriate on-line government resources.
- **6 – State** regulatory bodies should consider if interstate agreements combined with home-state licensing and discipline of certain businesses and professionals could effectively replace the current model in which each state requires licensing and performs its own enforcement. If California does not act, businesses and professionals licensed in other states – such as attorneys and accountants – will nevertheless make increasing use of the Internet to solicit business from, and perform services for, Californians. Under current regulatory schemes, they may well provide services to Californians without practical oversight or redress in California or their home states. *If* it is essential that a certain business or profession be regulated, then all of its practitioners providing services to Californians should operate under the same oversight system.

¹ AB 1629, http://www.leginfo.ca.gov/pub/bill/asm/ab_1601-1650/ab_1629_bill_980928_chaptered.html; AB 1676 http://www.leginfo.ca.gov/pub/bill/asm/ab_1651-1700/ab_1676_bill_980928_chaptered.html

² California Government Code, Section 16.5, <http://www.ss.ca.gov/digsig/code165.htm>; California Digital Signature Regulations, Final Text Approved By Office of Administrative Law on June 12, 1998, <http://www.ss.ca.gov/digsig/regulations.htm>.

³ AB 1614, http://www.leginfo.ca.gov/pub/bill/asm/ab_1601-1650/ab_1614_bill_980824_chaptered.html

⁴ See note 1, above.

⁵ SB 1386, http://www.leginfo.ca.gov/pub/97-98/bill/sen/sb_1351-1400/sb_1386_bill_19980911_chaptered.html

⁶ California Business and Professions Code, section 17538 (1996)